ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Alpert | Analyst: Garnier | Bill Number: SB 1496

Related Bills: ______ | Telephone: 845-5322 | Amended Date: 7/19/98

Attorney: Doug Bramhall | Sponsor: ______

SUBJECT: Conformity Act of 1998

__X__ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended APRIL 20, 1998.

_____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO ______________________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED APRIL 20 ,1998 STILL APPLIES.

__X__ OTHER - See comments below.

SUMMARY OF BILL

The Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), in general, conform to the Internal Revenue Code (IRC) either by incorporating the IRC by reference as of a "specified date" or by stand alone language which mirrors the federal provision. California law is conformed to the IRC as of January 1, 1997, unless a specific provision provides otherwise. This bill would change the specified date from January 1, 1997, to January 1, 1998, for taxable and income years beginning on or after January 1, 1998. Changing the specified date automatically conforms to all changes from January 1, 1997, through December 31, 1997, to IRC sections that have been previously incorporated by reference. Thus, California law would conform to most of the changes made to the federal income tax by the Taxpayers Relief Act of 1997.

This bill also would make numerous changes to specifically not conform or modify certain items in the IRC. Additionally, numerous technical changes regarding cross references and the deletion of unnecessary language that was used to conform to federal law changes subsequent to January 1, 1997, and prior to January 1, 1998, are being made by this bill.

SUMMARY OF AMENDMENT

The July 19, 1998, amendment would conform California law to two additional federal items that were not contained in the prior version of the bill: treatment of worker's compensation liability under rules for certain personal injury liability assignments and exclusion from "unrelated business income tax" (UBIT) for certain corporate sponsorship payments. This analysis discusses only these

Board Position:

__X__ S   _____ NA   _____ NP
_____ SA   _____ O   _____ NAR
_____ N   _____ OUA   _____ PENDING

Department Director: Gerald H. Goldberg   Date: 9/23/98 two changes in the bill.

The amendment also made numerous non-substantive technical changes to the bill. The majority of the technical changes were necessary to prevent chaptering problems with recently enacted SB 519 (Ch. 7, Stats. 1997) and AB 510 (Ch. 49, Stats. 1997). Other technical changes corrected grammar, cross references and drafting errors.

EFFECTIVE DATE

Unless otherwise specified this bill would apply to taxable and income years beginning on or after January 1, 1998.

SPECIFIC FINDINGS

64. Treatment of Worker's Compensation Liability under Rules for Certain Personal Injury Liability Assignments.

Under **federal and state law**, an exclusion from gross income is provided for amounts received for agreeing to a qualified assignment to the extent that the amount received does not exceed the aggregate cost of any qualified funding asset. A qualified assignment means any assignment of a liability to make periodic payments as damages (whether by suit or agreement) on account of a personal injury or sickness (in a case involving physical injury or physical sickness), provided the liability is assumed from a person who is a party to the suit or agreement, and the terms of the assignment satisfy certain requirements. Generally, these requirements are that: (1) the periodic payments are fixed as to amount and time; (2) the payments cannot be accelerated, deferred, increased, or decreased by the recipient; (3) the assignee's obligation is no greater than that of the assignor; and (4) the payments are excludable by the recipient under the IRC as damages on account of personal injuries or sickness.

Both **federal and state law** provide a separate exclusion for the recipient of amounts received under worker's compensation acts as compensation for personal injuries or sickness. However, **under prior federal and current state law** a qualified assignment under the IRC does not include the assignment of a liability to make such payments.

The federal **Tax Relief Act** (TRA) of 1997 extended the federal exclusion for qualified assignments under the IRC to amounts assigned for assuming a liability to pay compensation under any worker's compensation act. The TRA requires that the assignee assume the liability from a person who is a party to the worker's compensation claim, and requires that the periodic payment be excludable from the recipient's gross income under the IRC, in addition to the requirements of present law.

Prior to the TRA change**, California law** was in full conformity with federal law as it relates to exclusion of worker's compensation claims.

This bill would conform California law to federal law amended by the TRA as it relates to the assignment and exclusion of worker's compensation claims.

65. <u>Exclusion from UBIT for Certain Corporate Sponsorship Payments.</u>

Under both **federal and state law**, although generally exempt from income tax, tax-exempt organizations are subject to the unrelated business income tax (UBIT) on income derived from a trade or business regularly carried on that is not substantially related to the performance of the organization's tax-exempt functions. Contributions or gifts received by tax-exempt organizations generally are not subject to the UBIT. The law provides that an activity (such as advertising) does not lose its identity as a separate trade or business merely because it is carried on within a larger complex of other endeavors. If a tax-exempt organization receives sponsorship payments in connection with an event or other activity, the solicitation and receipt of such sponsorship payments <u>may</u> be treated as a separate activity.

Under the **TRA**, “qualified sponsorship payments” received by a tax-exempt organization (or state college or university) are exempt from the UBIT. Qualified sponsorship payments are defined as any payment made by a person engaged in a trade or business with respect to which the person will receive no substantial return benefit other than the use or acknowledgment of the name or logo (or product lines) of the person's trade or business in connection with the organization's activities. Such a use or acknowledgment does not include advertising of such person's products or services--meaning qualitative or comparative language, price information or other indications of savings or value, or an endorsement or other inducement to purchase, sell, or use such products or services. Thus, for example, if, in return for receiving a sponsorship payment, an organization promises to use the sponsor's name or logo in acknowledging the sponsor's support for an educational or fundraising event conducted by the organization, such payment will not be subject to the UBIT. In contrast, if the organization provides advertising of a sponsor's products, the payment made to the organization by the sponsor in order to receive such advertising will be subject to the UBIT (provided that the other, present-law requirements for UBIT liability are satisfied). In determining whether a payment is a qualified sponsorship payment, it is irrelevant whether the sponsored activity is related or unrelated to the organization's exempt purpose.

The **TRA** specifically provides that a qualified sponsorship payment does not include any payment where the amount of such payment is contingent, by contract or otherwise, upon the level of attendance at an event, broadcast ratings, or other factors indicating the degree of public exposure to an activity. However, the fact that a sponsorship payment is contingent upon an event actually taking place or being broadcast, in and of itself, will not cause the payment to fail to be a qualified sponsorship payment. Moreover, mere distribution or display of a sponsor's products by the sponsor or the tax-exempt organization to the general public at a sponsored event, whether for free or for remuneration, will be considered to be “use or acknowledgment” of the sponsor's product lines (as opposed to advertising), and thus will not affect the determination of whether a payment made by the sponsor is a qualified sponsorship payment.

The **TRA** provision does not apply to the sale of advertising or acknowledgments in tax-exempt organization periodicals. For this purpose, the term “periodical” means regularly scheduled and printed material published by (or on behalf of) the payee organization that is not related to and primarily distributed in connection with a specific event conducted by the payee organization. For example, the provision will not apply to payments that lead to acknowledgments in a monthly journal, but will apply if a sponsor receives an acknowledgment in a program or brochure distributed at a sponsored event. The determination if a payment for a logo or a product line acknowledgment in an organization's periodical is subject to UBIT is made under law existing prior (and subsequent) to the passage of the TRA.

The **TRA** provision specifically provides that, to the extent that a portion of a payment would (if made as a separate payment) be a qualified sponsorship payment, such portion of the payment will be treated as a separate payment. Thus, if a sponsorship payment made to a tax-exempt organization entitles the sponsor to both product advertising and use or acknowledgment of the sponsor's name or logo by the organization, then the UBIT will not apply to the amount of such payment that exceeds the fair market value of the product advertising provided to the sponsor. Moreover, the provision of facilities, services or other privileges by an exempt organization to a sponsor or the sponsor's designees (e.g., complimentary tickets, pro-am playing spots in golf tournaments, or receptions for major donors) in connection with a sponsorship payment will not affect the determination of whether the payment is a qualified sponsorship payment. Rather, the provision of such goods or services will be evaluated as a separate transaction in determining whether the organization has unrelated business taxable income from the event. In general, if such services or facilities do not constitute a substantial return benefit or if the provision of such services or facilities is a related business activity, then the payments attributable to such services or facilities will not be subject to the UBIT. Moreover, just as the provision of facilities, services or other privileges by a tax-exempt organization to a sponsor or the sponsor's designees (complimentary tickets, etc.) will be treated as a separate transaction that does not affect the determination of whether a sponsorship payment is a qualified sponsorship payment, a sponsor's receipt of a license to use an intangible asset (e.g., trademark, logo, or designation) of the tax-exempt organization likewise will be treated as separate from the qualified sponsorship transaction in determining whether the organization has unrelated business taxable income. The exemption provided by the provision will be in addition to other present-law exceptions from the UBIT (e.g., the exceptions for activities substantially all the work for which is performed by volunteers and for activities not regularly carried on).

California law is in conformity with federal law prior to the passage of the TRA, as it relates to "unrelated business income" of an exempt organization and the receipt of sponsorship payments.

This bill would conform California law to federal law amended by the TRA as it relates to the receipt of sponsorship payments by exempt organization.

FISCAL IMPACT

Tax Revenue Estimate

Tax revenue losses of $15 million, $29 million and $32 million for fiscal years 1998-99, 1999-00, and 2000-01, respectively.

Item 64, treatment of worker's compensation liability assignments, and item 65, exclusion of corporate sponsorship payments from UBIT, respectively result in minor and negligible losses.

The following table reflects the estimated impacts of the various provisions of this bill:

	AB 1496 (as proposed to be amended July 13, 1998)	**Personal Income Tax**			**Bank & Corporation Tax**		
		(in millions)			**(in millions)**		
	Description	**1998-9**	**1999-0**	**2000-1**	**1998-9**	**1999-0**	**2000-1**
1	Medicare Plus Choice distributions	(neg.impact)	(neg.impact)	(neg.impact)	-----	-----	-----
2	Hospitals participating in provider-sponsored organizations	(neg. loss)	(neg. loss)	(neg. loss)	-----	-----	-----
3	Deduction for student loan interest	($14)	($15)	($16)	-----	-----	-----
4	Qualified state tuition programs	No Revenue Impact			-----	-----	-----
5	Contributions of computer equipment to schools	-----	-----	-----	($4)	($4)	($4)
6	Cancellation of certain student loans	(minor loss)	(minor loss)	(minor loss)	-----	-----	-----
7	Repeal depreciation adjustment for AMT	($1)	($5)	($8)	(minor loss)	($1)	($1)
8	Repeal of throwback rules	-----	-----	-----	(minor loss)	(minor loss)	(minor loss)
9	Home office deduction	($3)	($8)	($9)	-----	-----	-----
10	Expensing of environmental remediation costs	($1)	($1)	(minor loss)	($6)	($5)	($2)
11	Shrinkage estimates for inventory accounting	(minor loss)	(minor loss)	(minor loss)	($1)	($1)	($1)
12	Timeshare associations	-----	-----	-----	(neg. loss)	(neg. loss)	(neg. loss)
13	Increased deduction of business meals for DOT employees	($1)	($1)	($1)	-----	-----	-----
14	Deductibility of meals provided for convenience of employer	Included in Section 969			-----	-----	-----
15	Modify limits on depreciation of luxury automobiles	-----	-----	-----	(neg. loss)	(neg. loss)	(neg. loss)
16	Suspension of income limit on percentage depletion	-----	-----	-----	($2)	($1)	(minor loss)
17	Mileage deduction for charitable use of auto	($2)	($2)	($2)	-----	-----	-----
18	Receivables purchased by coop hospitals	-----	-----	-----	(neg. loss)	(neg. loss)	(neg. loss)
19	Provide above-the-line deduction for certain business expenses	($1)	(minor loss)	(minor loss)	-----	-----	-----
20	Recognition of gain on certain appreciated financial positions a/	-----	-----	-----	-----	-----	-----
21	Mark-to-market election	Included in #20 above			-----	-----	-----
22	Limitation on exception for investment companies under sec 351	Included in #20 above			-----	-----	-----
23	Gains/losses on terminations of property	-----	-----	-----	$1	$1	$1
24	OID on pooled debt obligations	-----	-----	-----	$10	$11	$11
25	Deny interest deduction on certain debt instruments b/	-----	-----	-----	-----	-----	-----
26	Require gain recognition for certain extraordinary dividends	-----	-----	-----	$10	$2	$2
27	Require gain recognition on certain distrib. of controlled stock c/	-----	-----	-----	(minor gain)	(minor gain)	(minor gain)
28	Reform tax treatment of certain corporate stock transfers	-----	-----	-----	(minor gain)	(minor gain)	(minor gain)
29	Treat certain preferred stock as "boot"	-----	-----	-----	$2	$1	$1
30	Holding period for dividends received deduction	-----	-----	-----	(minor gain)	(minor gain)	(minor gain)
31	Reporting of certain payments made to attorneys d/	-----	-----	-----	-----	-----	-----
32	Beneficiaries of estates and trusts returns	(neg. gain)	(neg. gain)	(neg. gain)	-----	-----	-----
33	Registration of confidential corporate tax shelters	-----	-----	-----	$1	$1	$1
34	Extend UBIT rules to second-tier subs and amend control test	-----	-----	-----	(minor gain)	(minor gain)	(minor gain)
35	Basis allocation for partnership property distributions	$3	$2	$2	(minor gain)	(minor gain)	(minor gain)
36	Appreciation of inventory when partnership interest sold	(minor gain)	(minor gain)	(minor gain)	(neg. gain)	(neg. gain)	(neg. gain)
37	Extension of time for taxing precontribution gain				Included in Section 1062		
38	Cashout of certain accrued benefits e/	-----	-----	-----	-----	-----	-----
39	Cash in lieu of parking benefits f/	-----	-----	-----	-----	-----	-----
40	Basis recovery rules on annuities	(minor gain)	(minor gain)	(minor gain)	-----	-----	-----
41	Denial of certain amounts paid in connection with insurance	-----	-----	-----	$3	$4	$5
42	Limits on property using income forecast method g/	-----	-----	-----	-----	-----	-----
43	Replacement of involuntarily converted property	(minor gain)	(minor gain)	(minor gain)	-----	-----	-----
44	Exceptions to installment sales rules	-----	-----	-----	$4	$4	$4
45	Charitable remainder trust eligibility	-----	-----	-----	(neg. gain)	(neg. gain)	(neg. gain)
46	Estimated tax safe harbor rules (accelerated payments)	($4)	($1)	($1)	-----	-----	-----
47	Personal transactions & foreign currency gain	(neg. loss)	(neg. loss)	(neg. loss)	-----	-----	-----
48	Simplify formation and operation of international joint ventures	-----	-----	-----	(minor gain)	(minor gain)	(minor gain)
49	Eliminate AMT for children under 14	(neg. loss)	(neg. loss)	(neg. loss)	-----	-----	-----
50	Amt. of tax exempt from estimated tax rules (delayed payments) h/	($1)	(minor loss)	(minor loss)	-----	-----	-----
51	Reimbursed expenses of rural mail carriers	(neg. loss)	(neg. loss)	(neg. loss)	-----	-----	-----
52	Travel expenses of Federal employees	(neg. loss)	(neg. loss)	(neg. loss)	-----	-----	-----

53	Look-back method for long-term leases	(neg. loss)	(neg. loss)	(neg. loss)	(neg. loss)	(neg. loss)	(neg. loss)
54	Construction allowances for short-term leases	(neg. loss)	(neg. loss)	(neg. loss)	(neg. loss)	(neg. loss)	(neg. loss)
55	Close of partnership year & deceased partners	(neg. gain)	(neg. gain)	(neg. gain)	(neg. gain)	(neg. gain)	(neg. gain)
56	Reasonable cause exception for penalties	(neg. loss)	(neg. loss)	(neg. loss)	(neg. loss)	(neg. loss)	(neg. loss)
57	Statute of limitations on assessments	No Revenue Impact					
58	Estate tax provisions	(neg .loss)	(neg .loss)	(neg .loss)	-----	-----	-----
59	Interest on large corp. underpayments	-----	-----	-----	(neg. loss)	(neg. loss)	(neg. loss)
60	Pension simplification provisions	(neg. loss)	(neg. loss)	(neg. loss)	-----	-----	-----
61	Miscellaneous provisions relating to pensions and other benefits	($2)	($2)	($2)	($1)	($1)	($1)
62	Eliminate ACE adjustment for AMT	-----	-----	-----	($5)	($7)	($11)
64	Workers' comp/personal injury liability assignments	(minor loss)	(minor loss)	(minor loss)	-----	-----	-----
65	UBTI exclusion for sponsorship payments	-----	-----	-----	(neg. loss)	(neg. loss)	(neg. loss)
	TOTALS	($27)	($33)	($37)	$12	$4	$5
	Negligible = Loss or gain of less than $250,000						
	Minor = Loss or gain of less than $500,000						
a/	(#20) Baseline revenue gains of $10 million for 1997-8, $4 million for 1998-9, and $2 million annually thereafter will automatically occur.						
b/	(#25) Baseline rev. gains of $1 mil. annually will automatically occur as taxpayers structure debt instruments in response to the fed. law change.						
c/	(#27) Baseline revenue gains of $7 million beginning in 1997-8 will also occur.						
d/	(#31) Negligible baseline revenue gains annually beginning in 1998-9 will automatically occur.						
e/	(#38) Baseline revenue gains of less than $500,000 annually beginning in 1997-8 will occur automatically for state tax purposes.						
f/	(#39) Baseline revenue gains of less than $500,000 annually beginning in 1997-8 will occur automatically for state tax purposes.						
g/	(#42) Baseline revenue gains of less than $500,000 annually beginning in 1997-8 will occur automatically for state tax purposes.						
h/	(#50) This impact reflects increasing the estimated tax requirements to double the current law ($100 to $200 for married filing joint)						
	as proposed to be amended.						

BOARD POSITION

At its May 28, 1998, meeting, the Franchise Tax Board voted 2-0 to support this bill, with Robin J. Dezember, on behalf of Member Craig L. Brown, abstaining.